INTERNATIONAL SOVEREIGN ENERGY CORP.

2002 ANNUAL REPORT

Corporate Profile

International Sovereign Energy Corp. is a Canadian based publicly traded exploration and development company with offices in Vancouver British Columbia, Calgary Alberta and Islamabad Pakistan and is active in the exploration and development of hydrocarbon reserves in Western Canada and internationally.

The Company, incorporated in 1992, owns and operates a strong asset base of producing oil and gas properties in Western Canada that it continues to maintain through the drilling of internally generated low to medium risk exploration and development opportunities. This conservative, low risk approach to growth in Western Canada provides the Company with a substantial asset base from which to identify and pursue late stage exploration or early stage development opportunities internationally.

The Company is committed to maximizing shareholder value through the rapid growth expected from its international initiatives as well as through increasing its Western Canadian reserve base.

The shares of International Sovereign Energy Corp. are publicly traded on the TSX Venture Exchange under the symbol "ISR". At year-end 2002, the Company had 6,445,323 shares issued and outstanding.

Annual Meeting

The Annual General & Special Meeting of Shareholders of the Corporation will be held on Thursday, June 12, 2003 at 2:30 p.m. in the Grouse Room, 34th floor, at the Hyatt Regency Hotel located at 655 Burrard St., Vancouver, British Columbia. Shareholders and members of the public who are interested in receiving additional information on the Company are encouraged to attend.

Abbreviations

M	thousands
bbls/d	barrels per day
Mcf	thousands of cubic feet
Bcf	billions of cubic feet
bopd	barrels of oil per day
MM	millions
BOE	barrel of oil equivalent (1 bbl = 6 Mcf)
MMcf	millions of cubic feet
bbl	barrel
ARTC	Alberta Royalty Tax Credit
NGLs	natural gas liquids
BTU	British Thermal Unit

Contents

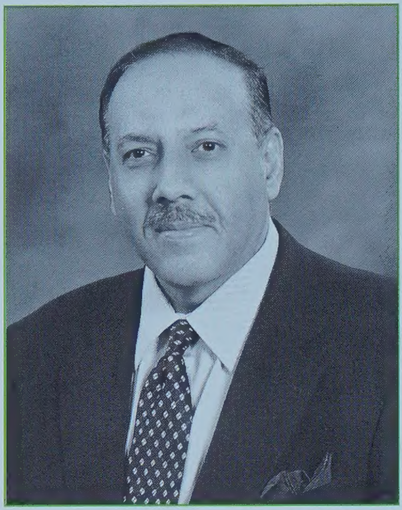
"Staying the course."

Highlights – Year in Review

	2002	2001
Operating		
Production		
Oil & NGLs (bbls)	**162,533**	154,070
Per day	**445**	422
Natural Gas (Mcf)	**322,432**	217,421
Per day	**883**	596
Exit Production		
Oil & NGLs (Mbbls)	**468**	384
Natural Gas (Mcf per day)	**891**	532
Proven and Probable Reserves		
Oil & NGLs (Mbbls)	**1,451**	1,690
Natural Gas (MMcf)	**3,933**	6,361
Average Price Received		
Oil ($ per bbl)	**29.16**	21.29
Natural Gas ($ per Mcf)	**3.51**	5.74

	2002	2001
Financial		
Gross Revenue	**$ 5,714,310**	$ 4,527,950
Cash Flow	**2,892,019**	1,896,121
Per Share	**0.45**	0.29
Net Income (Loss)	**728,926**	445,220
Per Share	**0.11**	0.07
Capital Expenditures	**2,571,033**	1,562,240
Acquisitions	**0.00**	0.00
Divestitures	**0.00**	15,000
Long Term Debt	**0.00**	0.00
Net Asset Value (15% dcf)	**15,566,498**	16,918,709
Per Share	**$ 2.42**	$ 2.63
Class A Common Shares Outstanding at Year End	**6,445,323**	6,445,323

Message to Shareholders



Lutfur Rahman Khan
Chairman of the Board

The year 2002 can best be described by the Company as a year of "staying the course". Management continued with its mandate to source and develop world-class international oil projects by targeting projects having large underdeveloped reserves with the potential to provide an exceptional return on investment to our shareholders.

Recognizing the vast potential of the Greater Caspian Region and the importance of the region as a new gas and oil producing center for the twenty-first century with its developing infrastructure and marketing opportunities, the Company has broadened its efforts in the area to include Kazakhstan, as well as Azerbaijan.

In Azerbaijan, the Company commenced its negotiations with SOCAR, the State Oil Company of the Azerbaijan Republic on the basic commercial terms for a new Production Sharing Contract for the rehabilitation, exploration and development of the Neftchala-Babazanan block. The Company has concluded its preliminary technical and commercial assessment of the block and is waiting for SOCAR'S internal review and approval of higher authorities in order to complete negotiations.

In Kazakhstan, the Company is taking advantage of the aggressive business climate in the country and the healthy perception by world financial markets. Unlike other countries in the region, Kazakhstan's hydrocarbon assets have already been privatized. With a lack of technical resources and financial capability, many of the local companies are looking to Western companies for cooperative development of their vast underdeveloped reserves. During the past year, International Sovereign has identified several exploration and development opportunities involving private companies in Kazakhstan and shall pursue these prospects in the upcoming months.

Ecuador remains an area of focus. International Sovereign has formed a strategic alliance with Amazoniagas S.A., a private company representing the Indigenous Nationalities of the Ecuadorian Amazon to jointly acquire and develop projects in the country. International Sovereign has identified an attractive project currently under the control of the state petroleum company, PetroEcuador. Significant progress was being made on this project when a change of government hampered our progress. The Company has resumed its efforts as the new government becomes more settled.

In Western Canada, the Company continues to develop internally generated prospects to maintain and grow our Western Canadian production base. Successful drilling operations at Clarke Lake and Little Bow are expected to add significant gas production to the Company's account. Additional drilling on the Company's 100% owned Marwayne property in the upcoming year is expected to push the production from this area to over 400 bopd. The Company's exit rate production for oil & natural gas liquids for 2002 was up 22% while gas exit rate showed an increase of 64% over the previous year. With the prospects

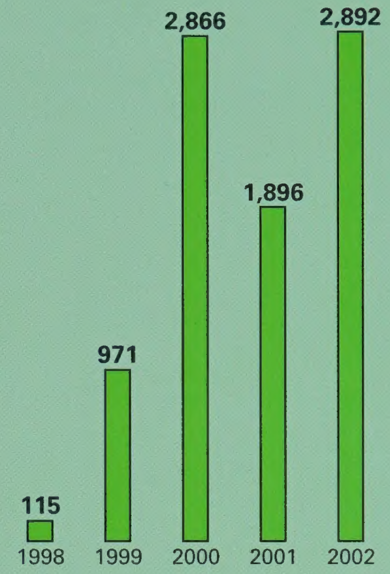
currently in our inventory, and with existing production pending tie-in, International Sovereign is confident that it will achieve its production targets during the upcoming year.

A strong WTI oil price for the year resulted in the Company averaging over $29.00 per barrel for its oil, netting back on average in excess of $18.00 for our significant heavy oil component of production. Fluctuating gas prices resulted in an average selling price of $3.51/Mcf for the year, a 39% decrease from the previous year. The effect of this decrease was offset by production increases resulting in cash flow of $0.45 per share for the year, a 53% increase over the previous year. The Company is pleased to report net earnings of $0.11 per share for the year, a 64% increase over the previous reporting period.

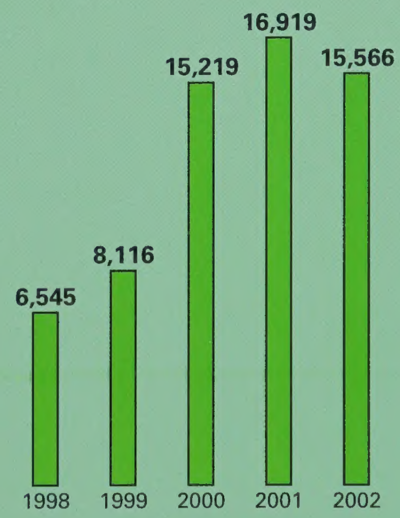
Developing a successful international oil company requires a technically strong and dedicated team of professionals, patience and perseverance. This past year, our team has worked diligently to put together a portfolio of international opportunities and domestic prospects that have the potential for great rewards to our shareholders. On behalf of the Board of Directors, I would like to thank our employees for their hard work and dedication as well as to our shareholders for their confidence and continued support.

Lutfur Rahman Khan
Chairman of the Board
April 11, 2003

Cash Flow
($ thousands)



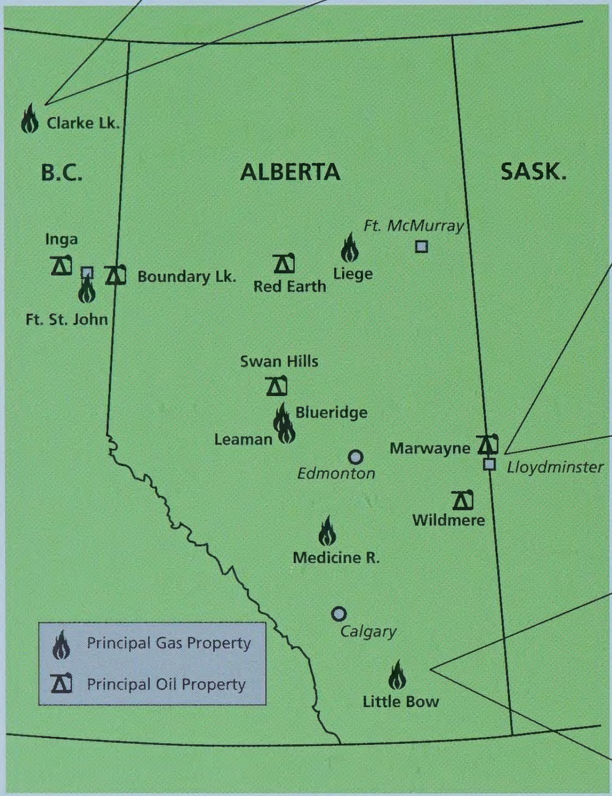
Net Asset Value
(15% DCF, $ thousands)



Operations and Production

Clarke Lake, B.C. – Slave Point Gas

2002 drilling of a new gas well, in addition to the re-completion of a suspended well and the work-over of an existing producer is expected to net the Company 1.5 MMcf/d by the close of 2003.

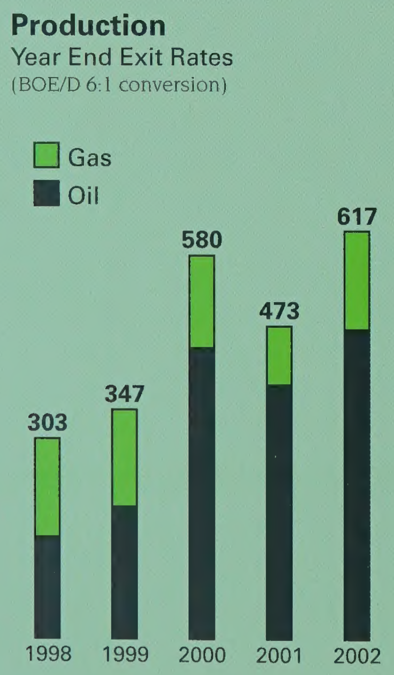


Marwayne, Alberta – Sparky, GP Oil

Optimization of existing wells in 2002 plus the identification of three new well locations for 2003 is expected to add 100 bopd net to the Company increasing production to over 400 bopd on this 100% property.

Little Bow, Alberta – Bow Island Gas

Follow-up to a dry hole drilled the previous year has resulted in one new gas well and a follow-up location that combined are forecast to net the Company an additional 500 Mcf/d.



The Company exited 2002 with production increases of approximately 22% for oil and 67% for gas over the previous year, participating in the drilling of two successful gas wells and one dry hole for the year.

The drilling of the new a-54-G gas well at Clarke Lake, combined with the successful re-completion of the a-61-F well, the proposed optimization of existing producers and the increased water handling capability will make this a major gas producing property for International Sovereign.

The increase in gas production at Clarke Lake, along with the new gas production at Little Bow should achieve the Company's objective of bringing its product mix into balance for the upcoming year.

International Highlights

Azerbaijan

A Memorandum of Understanding was signed with SOCAR (State Oil Company of the Azerbaijan Republic) giving International Sovereign the right to negotiate the terms of a new agreement for the rehabilitation, exploration and development of the largest onshore block in the country. The negotiations are ongoing and we are waiting for SOCAR to complete their internal review.

Kazakhstan

International Sovereign has expanded its focus in the Caspian region to include Kazakhstan. Several projects are under negotiation with local private companies that involve the development of proven reserves and exploration of associated licensed territories.

Pakistan

The Company continues to maintain a small field office in Islamabad to take advantage of the ongoing opportunities being offered resulting from the privatization of government owned interests in the country's hydrocarbon sector. Events in the Middle East and South-Central Asia during the past months have temporarily delayed the country's plans for the privatization of certain industries.

Ecuador

The Company has been very active in identifying specific projects of interest within the country and has initiated discussions with PetroEcuador, the state owned oil company regarding these projects. A strategic alliance has been established with Amazoniagas S.A., a company representing the Indigenous Nationalities of the Ecuadorian Amazon to jointly pursue and develop these opportunities.

"Developing a successful international oil company requires a strong, dedicated team of professionals, patience and perseverance."

Reserves

The Company's proved plus probable reserves decreased by 23% during the year, with oil and NGLs down 14% and natural gas down 38%. These results were attributable to reductions in probable reserves previously booked at our Blueridge, Alberta prospect that were downgraded significantly after drilling a marginal well and a reduction in proved producing reserves attributable to a Medicine River gas well whose performance has been less than anticipated. Over 86% of the Company's reserve base is categorized as proven.

The product mix of the Company remains weighted to oil and NGLs with liquids comprising 69% of the corporate reserves, compared to 61% for the previous year. The Company's upcoming capital projects for 2003 are heavily weighted towards increasing gas production, leading to more balanced output in future.

Based on the 2002 average production rate, the Company's overall proved plus probable reserve life index is an enviable 9.7 years, 8.4 years based on proved reserves alone. The reserve life indices for gas and oil plus liquids individually are 8.0 and 8.5 years for proved reserves, and 12.2 and 8.9 years for proved plus probable reserves, respectively.

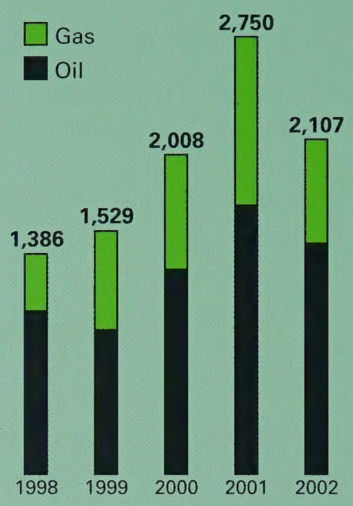
The table below presents the Company's proved plus probable reserves before royalties as evaluated by the independent firm of Chapman Petroleum Engineering Ltd. as at January 1, 2003.

Reserves

	Proved	Probable	Total
Gas (MMcf)	2,581	1,352	3,933
Oil (Mbbls)	1,366	53	1,419
NGLs (Mbbls)	22	10	32
Total (MBOE)	1,818	288	2,107

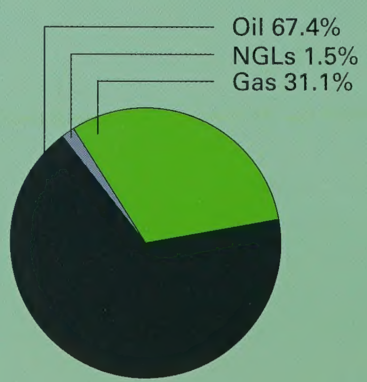
"86% of the Company's reserves are proved."

Reserves
Proved plus Probable
(MBOE 6:1 conversion)



Net Present Value of Proved plus Probable Reserves
(10% DCF, $ thousands)

Reserve Allocation
Proved plus Probable
(MBOE 6:1 conversion)



Management's Discussion and Analysis

Production and Revenue

Revenues for the period were $5,714,310, an increase of 26% over the 2001 level of $4,527,950. This increase was due to increased production throughout the year and high commodity prices at the end of 2002, particularly for heavy oil. Average oil prices rose 37% from $21.29/Bbl in 2001 to $29.16/Bbl in 2002. Average gas prices fell 39% from $5.74/Mcf in 2001 to $3.51/Mcf in 2002. This difference was primarily due to very low prices during the summer months; by the end of 2002 prices had recovered to the $5.75/Mcf range. Although average gas prices were lower over the period, gas production increased 48% over 2001, from 596 Mcf/d to 883 Mcf/d. This was primarily attributable to the Clarke Lake wells coming back on production in March of 2003 after the repair of a pipeline break that occurred in 2001. Average oil and NGL production rates increased 5% to 445 bbls/d from 422 bbls/d the year prior.

Royalties

Royalties, net of Alberta Royalty Tax Credit decreased slightly by 9% from $648,030 in 2001 to $592,350 in 2002. This was partially because the 2001 number had reflected substantial adjustments to the fourth quarter of 2000 at Clarke Lake when gas prices had been at unprecedented highs, and particularly due to lower gas crown royalty rates as a result of lower gas prices in general.

Operating Costs

Operating costs totalled $1,193,478 in 2002, which equates to $5.52 BOE, down 9% from $6.09 BOE in 2001. This decrease is mainly due to 2001 costs being higher as adjustments to previous years were billed to the Company in 2001. Actual operating costs/BOE were fairly constant between the two years. In spite of rising fuel costs in 2002, the Company's efforts in conserving and consuming more casing gas has resulted in flat to declining costs for lease fuel.

General and Administrative

Total general and administrative expenses, net of recoveries increased from $801,383 in 2001 to $989,681 in 2002. This increase was the result of increased activity within the Company, requiring increased technical consulting services both for domestic and foreign prospects.

Interest

The 2002 interest expense was up slightly from $23,655 to $27,567. Interest expense has been minimal for the past two years, as the available line of credit has only been drawn to a minor extent, and was undrawn upon at the year end 2002.

Depletion, Depreciation and Site Restoration

Total depletion, depreciation and site restoration provision was $1,627,619 as compared to $1,074,732 in 2001. This substantial increase was the result of capitalized costs of $619,487 related to the impairment of certain international cost centres having been charged to depletion. The depletion rate before these changes per BOE in 2002 was $4.14, down slightly from $4.90 in 2001.

Capital Expenditures

Total capital expenditures for the year were $2,642,755 up 69% from $1,562,240. This increase was the result of increases in spending on operations consisting of drilling and completions, re-completions, workovers and abandonments, and capitalized G&A on international projects.

Liquidity and Capital Resources

At December 31, 2002 International Sovereign's market value of common shares was $4,253,913 based on the closing price of $0.66 per share times 6,445,323 shares outstanding. Cash flow from operations was $2,892,019 up 53% from $1,896,121 at the end of 2001. This equated to an increase from $0.29 per basic share in 2001, to $0.45 per basic share in 2002. At the end of 2002 International Sovereign has a $4,600,000 credit line, which is currently undrawn upon.

Business Risks

The oil and gas industry is subject to numerous risks, including commodity prices, interest rates, exchange fluctuations, as well as environmental concerns and the success of future drilling. International Sovereign attempts to reduce and manage those risks, which are controllable.

Safety and Environmental

Safety and environmental concerns are addressed through a corporate contingency plan and by continued emphasis on complying with environmental regulations.

Stock-Based Compensation and Other Stock-Based Payments

The Company has a stock-based compensation plan, which is described in Note 6 to the accompanying financial statements. In 2002, the Company accounts for

its stock-based compensation plan using intrinsic-values. Using intrinsic-values of the stock options, compensation costs are not recognized in the consolidated financial statements for share options granted at market value. Effective January 1, 2002, Canadian accounting standards require disclosure of the impact on net income of using the fair market value method for stock options issued on or after January 1, 2002.

Impact of New Accounting Pronouncements

In November 2002, the Canadian Institute of Chartered Accountants ("CICA") amended its accounting guidelines on hedging relationships, which was originally issued in November 2001. The guideline establishes certain conditions where hedge accounting may be applied. It is effective for years beginning on or after July 1, 2003.

In December 2002, the CICA issued a new standard on the impairment of long-lived assets, which is effective for years beginning on or after April 1, 2003. The new standard requires an impairment loss for a long-lived asset to be held and used to be recognized when its carrying amount exceeds the sum of the undiscounted cash flows expected from its use and eventual value, and provides guidance on how to determine fair value.

In December 2002, the CICA issued a new standard on the disposal of long-lived assets and discontinued operations, which is effective for disposal activities initiated by a company's commitment to a plan on or after May 1, 2003. The new standard requires an asset classified as held for sale to be measured at fair value less cost to sell, provides criteria for classifying assets as held for sale and classifying a disposal as discontinued operations, and specifies presentations and disclosures for discontinued operations and other disposals of long-lived assets.

In December 2002, the CICA issued a new standard on the accounting for asset retirement obligations. This standard, requires recognition of a liability for the future retirement obligations associated with property, plant and equipment. These obligations are initially measured at fair value, which is the discounted future value of the liability. The liability accretes until the date of expected settlement of the retirement obligations. The new standard is effective for all fiscal years beginning on or after January 1, 2004, however earlier adoption is encouraged.

Outlook

International Sovereign is well positioned entering the 2003 year. The Company currently has no debt and at the time of writing has already carried out several successful drilling and recompletion projects in the first and second quarters, which have been financed out of cash flow and are expected to add significant value. The Company anticipates 2003 to be the most active year in history in terms of capital spending. A number of prospects are scheduled already, and several more will be added throughout the year.

2002 Quarterly Information

$	Qtr1	Qtr2	Qtr3	Qtr4	Annual
Gross Revenues after Royalties	828,359	1,518,515	1,350,541	1,428,925	5,126,340
Cash Flow from Operations	449,724	1,001,167	832,030	609,098	2,892,019
Basic Per Share	0.07	0.16	0.13	0.09	0.45
Diluted Per Share	0.07	0.15	0.13	0.09	0.44
Net Income	138,971	607,045	181,033	(198,123)	728,926
Basic Per Share	0.02	0.09	0.03	(0.03)	0.11
Diluted Per Share	0.02	0.09	0.03	(0.03)	0.11

2001 Quarterly Information

$	Qtr1	Qtr2	Qtr3	Qtr4	Annual
Gross Revenues after Royalties	1,261,893	985,520	1,068,006	596,149	3,911,568
Cash Flow from Operations	840,142	450,617	521,776	83,586	1,896,121
Basic Per Share	0.13	0.07	0.08	0.01	0.29
Diluted Per Share	0.13	0.07	0.08	0.01	0.29
Net Income	569,261	193,218	221,593	(538,652)	445,420
Basic Per Share	0.09	0.03	0.03	(0.08)	0.07
Diluted Per Share	0.09	0.03	0.03	(0.08)	0.07

Management's Report

To the Shareholders of International Sovereign Energy Corp.

The information contained in this annual report and the accompanying financial statements and other financial information as well as the reporting process that produces such statements is the responsibility of Management.

Management maintains a system of internal controls designed to reasonably assure that transactions are appropriately authorized, that relevant and reliable financial information is produced in a timely manner and that the assets of the Corporation are adequately safeguarded.

The Management of the Company has the responsibility for the integrity and objectivity of the information contained in this annual report and to ensure that the operating information presented throughout this annual report is consistent with that shown in the financial statements, which are prepared by Management in accordance with generally accepted accounting principles.

The external auditors, appointed by the shareholders of the Company have examined the financial statements in order to provide an independent view as to the fairness of reported operating results and financial condition.

The Audit Committee of the Board of Directors which consists primarily of non-management directors have reviewed the financial statements including notes thereto, with Management and has reported to the Board of Directors.

The financial statements, upon the recommendation of the Audit Committee, have been approved by the Board of Directors.

Lutfur Rahman Khan
Chief Executive Officer

Don Campbell

Donald G. Campbell
Chief Operating Officer

Auditors' Report

To the Shareholders of International Sovereign Energy Corp.

We have audited the consolidated balance sheets of International Sovereign Energy Corp. (the "Company") as at December 31, 2002 and 2001 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and 2001 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Calgary, Alberta
February 28, 2003

Deloitte & Touche LLP
Chartered Accountants

Consolidated Balance Sheets

December 31,	2002 $	2001 $
ASSETS		
CURRENT		
Cash	**13,057**	–
Accounts receivable	**598,693**	665,197
Prepaid expenses and deposits	**6,800**	6,800
	618,550	671,997
Property and equipment (Note 3)	**11,099,130**	10,076,369
	11,717,680	10,748,366
LIABILITIES		
CURRENT		
Bank indebtedness	**–**	118,823
Accounts payable and accrued liabilities	**592,061**	580,949
Operating loan (Note 4)	**–**	195,000
	592,061	894,772
Future income tax liability (Note 5)	**2,806,800**	2,271,326
Site restoration and abandonment provision	**211,991**	204,366
	3,610,852	3,370,464
SHAREHOLDERS' EQUITY		
Share capital (Note 6)	**6,234,734**	6,234,734
Retained earnings	**1,872,094**	1,143,168
	8,106,828	7,377,902
	11,717,680	10,748,366

Approved by the Board

Director

Director

Consolidated Statements of Operations and Retained Earnings

Years Ended December 31,	2002	2001
	$	$
REVENUE		
Petroleum and natural gas revenues	**5,714,310**	4,527,950
Royalties, net of ARTC	**(592,350)**	(648,030)
Other income	**4,380**	31,648
	5,126,340	3,911,568
EXPENSES		
Operating costs	**1,193,478**	1,159,027
General and administrative	**989,681**	801,383
Interest	**27,567**	23,655
Depletion and depreciation	**1,548,272**	1,006,935
Site restoration	**79,347**	67,797
	3,838,345	3,058,797
EARNINGS BEFORE INCOME TAXES	**1,287,995**	852,771
INCOME TAXES (Note 5)		
Current	**23,595**	31,382
Future	**535,474**	376,169
	559,069	407,551
NET EARNINGS (Note 8)	**728,926**	445,220
RETAINED EARNINGS, BEGINNING OF YEAR	**1,143,168**	697,948
RETAINED EARNINGS, END OF YEAR	**1,872,094**	1,143,168

Consolidated Statements of Cash Flows

Years Ended December 31,	2002 $	2001 $
CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net earnings	728,926	445,220
Adjustments for:		
Depletion and depreciation	1,548,272	1,006,935
Site restoration	79,347	67,797
Future income taxes	535,474	376,169
Cash flow from operations (Note 8)	2,892,019	1,896,121
Site restoration costs	(71,722)	(73,467)
	2,820,297	1,822,654
Changes in non-cash working capital		
Accounts receivable	66,504	134,029
Accounts payable and accrued liabilities	11,112	181,784
	2,897,913	2,138,467
FINANCING		
Decrease in operating loan	(195,000)	(420,000)
	(195,000)	(420,000)
INVESTING		
Additions to property and equipment	(2,571,033)	(1,488,773)
Proceeds on sale of property and equipment	–	15,000
Proceeds on exercise of stock options	–	1,300
	(2,571,033)	(1,472,473)
NET INCREASE IN CASH AND CASH EQUIVALENTS	131,880	245,994
BANK INDEBTEDNESS, BEGINNING OF YEAR	(118,823)	(364,817)
CASH (BANK INDEBTEDNESS), END OF YEAR	13,057	(118,823)
SUPPLEMENTARY INFORMATION		
Cash taxes paid	61,372	501
Cash interest paid	27,683	23,655

Notes to the Consolidated Financial Statements

Years Ended December 31, 2002 and 2001

1. NATURE OF BUSINESS

International Sovereign Energy Corp. (the "Company") is in the business of exploration for and development of petroleum and natural gas interests.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and practices.

Consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary incorporated in Ecuador.

Cash and cash equivalents

Cash and cash equivalents include cash and short-term investments with a maturity of 90 days or less at the time of issue.

Property and equipment

The Company follows the full cost method of accounting for oil and gas operations as prescribed by the Canadian Institute of Chartered Accountants. All costs related to exploration and development of oil and gas reserves are capitalized in cost centers on a country-by-country basis. Such costs include lease acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling productive and non-productive wells and overhead charges related directly to acquisition, exploration and development activities.

Costs of acquiring and evaluating unproven properties in Canada and costs of exploration and land in international cost centers are excluded initially from costs subject to depletion, until it is determined whether or not proved reserves are attributable to the properties or, in the case of major development projects, commercial production has commenced, or impairment has occurred. Impairment occurs whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When proven reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion. Proceeds from disposal of properties will normally be applied as a reduction of the cost of the remaining assets unless the disposal represents a significant disposition of reserves, in which case a gain or loss will be recorded.

The net carrying value of the Company's petroleum and natural gas properties is limited to an ultimate recoverable amount. This is the aggregate of future net revenues from estimated proved reserves and the costs of unproved properties, net of impairment allowances, less future general and administrative costs, financing costs, site restoration and abandonment costs, and income taxes. Future net revenues are estimated using year end prices and all costs are assumed to be constant.

For each cost center, the capitalized costs associated with proved reserves, including the costs of production equipment, are depleted and depreciated on the unit-of-production method based on the estimated proven reserves before royalties, determined by independent petroleum engineers. Oil and gas reserves and production are converted into equivalent units based upon estimated relative pricing content at a ratio of six thousand cubic feet of gas to one barrel of oil.

Site restoration and abandonment

The estimated cost for future site restoration and abandonment is provided on the unit-of-production method based on the estimated remaining proven reserves and is included in site restoration expense. Estimates are prepared by the Company's engineers based on current costs and regulations in effect at the consolidated balance sheet date. Actual site restoration and abandonment expenditures are charged to the accumulated provision account as incurred.

Revenue recognition

Petroleum and natural gas sales are recognized when the commodities are delivered to purchasers.

Joint venture accounting

A portion of the Company's exploration and production activities is conducted jointly with others and, accordingly, these consolidated financial statements reflect only the Company's proportionate interest in such activities.

Financial instruments

The carrying values of accounts receivable, accounts payable and accrued liabilities and operating loan approximate the fair value of these financial instruments due to the short-term maturity of these instruments.

Foreign currency translation

Transactions of the Company and its subsidiaries that are denominated in foreign currencies are recorded in Canadian dollars at exchange rates in effect at the related transaction dates. Assets and liabilities denominated in foreign currencies are adjusted to reflect exchange rates at the consolidated balance sheet date. Exchange gains and losses arising on the translation of monetary assets and liabilities are included in the determination of income for the year.

Stock-based compensation plan

The Company has a stock-based compensation plan, which is described in Note 6. In 2002, the Company accounts for its stock-based compensation plan using intrinsic-values. Using intrinsic-values of the stock options, compensation costs are not recognized in the consolidated financial statements for share options granted at market value. Effective January 1, 2002, Canadian accounting standards require disclosure of the impact on net income of using the fair value method for stock options issued on or after January 1, 2002.

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Future income taxes

The Company accounts for future income taxes using the liability method. Future income tax assets and liabilities are measured based upon temporary differences between the carrying values of assets and liabilities and their tax bases. Income tax expense is computed based on the change during the year in the future tax assets and liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. Effects of changes in tax laws and tax rates are recognized when enacted.

Earnings per share

Basic earnings per common share is calculated using the weighted average number of common shares outstanding during the year. Diluted earnings per share is calculated on the basis of the weighted average number of shares outstanding during the year plus the additional common shares that would have been outstanding if stock options were exercised and potentially dilutive common shares had been issued, using the "treasury stock" method.

3. PROPERTY AND EQUIPMENT

	2002 **$**	2001 $
Petroleum and natural gas properties	**16,279,212**	13,716,232
Furniture and equipment	**240,651**	232,598
	16,519,863	13,948,830
Less accumulated depletion and depreciation	**5,420,733**	3,872,461
	11,099,130	10,076,369

During the year, the Company capitalized general and administrative expenditures of $939,982 (2001 – $568,309) directly related to both Canadian and international exploration and development activities.

Costs of $2,046,776 related to undeveloped properties were not subject to depletion during year ended December 31, 2002 (2001 – $1,226,509). At year end December 31, 2002, capitalized costs of $619,487 related to the impairment of certain international cost centers have been charged to depletion.

Site restoration amortization expense of $79,347 for the year ended December 31, 2002 is based on a total future estimated liability of $1,034,700 (2001 – $1,037,500).

4. OPERATING LOAN

During the year, the Company obtained a revolving line of credit to a maximum of $4,600,000. The operating loan bears interest at prime plus 0.75%. The operating loan is secured by a demand debenture for a minimum of $5,000,000, providing a floating charge over all assets of the Company, and a letter of undertaking not to encumber or dispose of assets, other than in the normal course of business, without consent of the Bank, and to provide security under section 426 of the Bank Act and/or assign natural gas contracts. At December 31, 2002, there was no balance outstanding with respect to this facility (2001 – $195,000). In addition, the lender has issued on behalf of the Company letters of credit totaling $7,500 (2001 – $7,500).

5. FUTURE INCOME TAXES

The provision for taxes varies from the amounts that would be computed by applying the effective Canadian federal and provincial income tax rates to earnings before taxes as shown below:

	2002 **$**	2001 $
Earnings before income taxes	**1,287,995**	852,771
Corporate income tax rate	**42.12%**	42.62%
Computed income tax provision	**542,503**	363,451
Increase (decrease) resulting from:		
Non-deductible crown charges, net of ARTC	**239,818**	238,501
Resource allowance rate reduction	**(43,656)**	23,011
Taxable (deductible) resource allowance	**(154,974)**	(73,710)
Attributed Canadian royalty income recognized	**(36,312)**	(53,175)
Non-deductible meals, entertainment and life insurance	**3,307**	3,038
Capital tax	**2,268**	962
Impact of changes in effective tax rate	**(26,646)**	(77,288)
Other	**32,761**	(17,239)
	559,069	407,551

The major components of the future income tax liability at December 31 using a combined federal and provincial rate of 42.12% (2001 – 42.62%) are as follows:

	Future Tax Liability	
	2002 **$**	2001 $
Taxable temporary differences:		
Carrying value in excess of tax basis	**3,014,249**	2,426,720
Attributed Canadian royalty income carryforward	**(163,793)**	(132,384)
Differences in capital cost allowance claim for resource allowance	**(43,656)**	(23,010)
Balance, December 31	**2,806,800**	2,271,326

6. SHARE CAPITAL

	Number of Shares	**Amount** **$**
Authorized		
Unlimited number of Class A common voting shares		
Unlimited number of Class B common non-voting shares		
Unlimited number of Class A preferred voting, 7%, non-cumulative, redeemable shares		
Issued		
Class A common shares	6,442,723	**6,233,434**
Balance, December 31, 2000	6,442,723	**6,233,434**
Exercise of stock options	2,600	**1,300**
Balance, December 31, 2001 and 2002	6,445,323	**6,234,734**

Stock option plan

Under the Company's stock option plan, the Company may grant options to its directors, officers and key employees to purchase Class A common shares ("Common Shares") from the Company at a fixed price not less than the fair market value of the stock on the day preceding the grant date. The Company has 644,532 common shares authorized for grants of options. The options would be exercisable equally over three years. The option's maximum term is five years.

	Options	Weighted Average Exercise Price $
As at December 31, 2000	494,667	0.50
Granted	–	–
Cancelled	(24,400)	0.50
Exercised	(2,600)	0.50
As at December 31, 2001	467,667	0.50
Granted	175,000	0.65
Cancelled	(58,000)	–
As at December 31, 2002	584,667	0.55
Exercisable at December 31, 2002	409,667	0.50

The following table summarizes information about stock options outstanding at December 31, 2002:

Range of Exercise Price(s) $	Options Outstanding at December 31, 2002	Weighted Average Remaining Contractual Life (Years)	Exercisable Exercise Price $	Weighted at at December 31, 2002	Average Exercise Price $
0.50	404,667	2.1	0.50	404,667	0.50
0.60	5,000	2.6	0.60	5,000	0.60
0.65	175,000	4.9	0.65	–	0.65
0.50 – 0.65	584,667			409,667	

Pro forma accounting for stock-based compensation

Effective January 1, 2002, the Canadian Institute of Chartered Accountants recommends that stock-based compensation be accounted for using a fair value methodology. As permitted under the new rules, the Company has elected to measure compensation expense as the difference, if any, between the quoted market value or fair value of the stock at the date of grant and the exercise price at the date of grant. The exercise price of options granted by the Company is not less than the market value at the date of grant and, consequently, no compensation expense has been recorded.

If compensation costs for options for common shares of the Company issued on or after January 1, 2002 has been determined based on the fair value methodology, using the Black-Scholes option pricing model, the Company's net earnings and earnings per share would have been decreased to the pro forma amounts indicated below:

Year Ended December 31, 2002	$
Net earnings applicable to common shareholders as reported	**728,926**
Pro forma net income applicable to common shareholders	**727,939**
Earnings per common share as reported (basic and diluted)	**0.11**
Pro forma earnings per common share (basic and diluted)	**0.11**

The fair value of each option grant by the Company was estimated using the Black-Scholes option pricing model assuming no dividends are paid on common shares, a risk-free interest rate of 4.06%, an average life of 5 years and a volatility of 89%. The amounts computed according to the Black-Scholes option pricing model may not be indicative of the actual values realized upon the exercise of these options by the holders.

7. RELATED PARTY TRANSACTIONS

During the year, the Company recovered general and administrative expenses totaling $33,357 (2001 – $24,000) from a corporation which has a director in common with the Company. At December 31, 2002, accounts payable of $22,683 (2001 – $30,992) include balances owing to a company which have a director in common with the Company. During the year, the Company paid $43,833 (2001 – $45,727) for legal services in the normal course of business to a law firm of which the partner is an officer of the Company. Transactions are determined at carrying amounts which approximates fair value.

8. EARNINGS AND CASH FLOW FROM OPERATIONS PER COMMON SHARE

	2002	2001
Earnings per common share		
Basic and diluted	**$0.11**	$0.07
Cash flow from operations per common share		
Basic	**$0.45**	$0.29
Diluted	**$0.44**	$0.29
Weighted average number of common shares		
Basic	**6,445,323**	6,445,142
Diluted	**6,551,018**	6,578,047

No options were excluded from diluted earnings per share as all the options were in the money in both 2002 and 2001.

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company is subject to normal industry credit risk on its accounts receivable with customers and joint venture partners. The Company mitigates these risks by only entering into agreements with credit worthy parties.

The Company is exposed to fluctuations in commodity prices for natural gas, crude oil and natural gas liquids. Commodity prices are affected by many factors including supply, demand and the Canadian to US dollar exchange rate. The Company's operating loan is also exposed to fluctuations in short-term Canadian interest rates. The Company has no financial hedges or fixed price commodity contracts in place at December 31, 2002.

The fair market value of financial instruments consisting of cash, accounts receivable, prepaid expense and deposits, accounts payable and accrued liabilities approximate their carrying value due to their short-term nature. The operating loan bears interest at a floating market rate, accordingly, the carrying value approximates the fair value.

10. COMMITMENT

The Company has committed to a lease for premises expiring in August of 2006. The minimum annual payments required on the lease are $62,171.

11. SEGMENTED INFORMATION

The Company sells its petroleum and natural gas products to various purchasers. For 2002, three integrated purchasers accounted for 72%, 10%, and 6% (2001 – 56%, 8%, and 14%) of the Company's gross revenues respectively.

The Company's core area of operation is in Canada. The Company is currently investigating opportunities in other countries. Total costs spent in 2002 on international investigations were $820,268 (2001 – $529,135).

Corporate Information

Directors

Lutfur Rahman Khan (2*)(3*)

Mahmood Arshad (1*)

Omair Choudhry (2)

Donald G. Campbell (3)

Dr. Waseem Rahman (1)(3)

Arman Aziz (1)(2)

(1) Member of the Audit Committee

(2) Member of the Compensation Committee

(3) Member of the Executive Committee

* Denotes Chairman

Officers

Lutfur Rahman Khan

Chairman, President and Chief Executive Officer

Donald G. Campbell

Sr. Vice President Engineering & Production and Chief Operating Officer

George P. Bowley

Sr. Vice President Exploration & Development

Dr. Waseem Rahman

Sr. Vice President Administration

Omair Choudhry

Sr. Vice President Finance & Personnel

Nadeem R. Khan

Sr. Vice President Business Development

Timothy S. Hoar

Corporate Secretary & General Counsel

Lutfur Rahman Khan
Chairman of the Board and Chief Executive Officer

Donald G. Campbell
Sr. Vice President Engineering & Production and Chief Operating Officer

George P. Bowley
Sr. Vice President Exploration & Development

Omair Choudhry
Sr. Vice President Finance & Personnel

Dr. Waseem Rahman
Sr. Vice President Administration

Timothy S. Hoar
Corporate Secretary & General Counsel

Executive Office, Vancouver

502, 815 Hornby Street
Vancouver BC
Canada V6Z 2E6
Tel: (604) 684-7372
Fax: (604) 684-2407

Operations Office, Calgary

1750, 801 – 6th Avenue S.W.
Calgary, AB
Canada T2P 3W2
Tel: (403) 263-2472
Fax: (403) 264-7035

Overseas Office

No. 9 Street 40
Sector F – 7/1
Islamabad, Pakistan
Tel: 92-51-265 1732
Fax: 92-51-265 1731

Registrar and Transfer Agent

Valiant Trust Company
Calgary, AB

Banker

The Bank of Nova Scotia
Calgary, AB

Auditors

Deloitte & Touche LLP
Calgary, AB

Independent Engineers

Chapman Petroleum Engineering Ltd.
Calgary, AB

Legal Counsel

ProVenture Law
Calgary, Alberta

Stock Exchange Listing

TSX Venture Exchange
Symbol "ISR"

ced by ion communications

International
Sovereign Energy Corp.

Executive Office, Vancouver
502, 815 Hornby Street
Vancouver, BC
Canada V6Z 2E6

Operations Office, Calgary
1750, 801 – 6th Avenue S.W.
Calgary, AB
Canada T2P 3W2

www.internationalsovereign.com